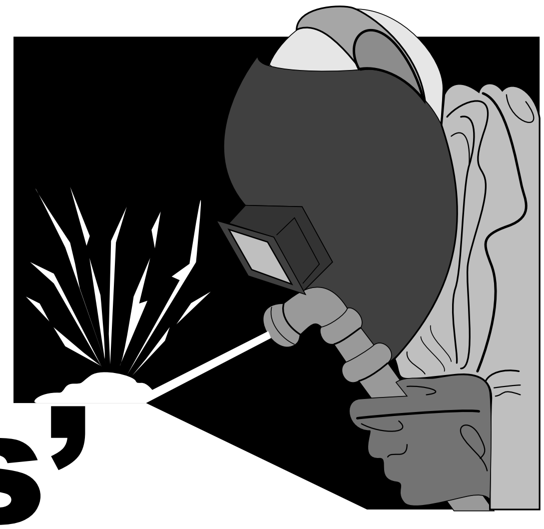


Workers' Compensation Rating Guide

State of Alaska
Department of Community
and Economic Development

DIVISION OF INSURANCE

Workers' Compensation Rating Guide

June 1999

State of Alaska
Department of Community
and Economic Development

DIVISION OF INSURANCE

Tony Knowles
Governor

Deborah B. Sedwick
Commissioner

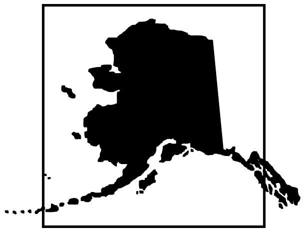
Marianne K. Burke
Director

Prepared by:

Sarah McNair-Grove
Actuary

Table of Contents

Forward



The Alaska Division of Insurance has prepared this guide to help Alaskan employers understand some of the basics of workers' compensation insurance.

Alaska laws require that most employers provide workers' compensation benefits for their employees in case of injury or death on the job. These benefits include payment of all medical expenses (nurses' and doctors' fees, hospital charges, medicine, transportation to nearest medical facilities, burial expenses, and death benefits) and compensation for lost wages. The weekly rate for compensation for disability or death is determined by the state legislature and written in statute. This section of the law is administered by the Division of Workers' Compensation in the Department of Labor. Questions requiring an explanation of benefit amounts, payments, or other claims related issues should be addressed to the Division of Workers' Compensation.

Employers may comply with the law to provide workers' compensation benefits either by purchasing workers' compensation insurance from an insurance company authorized to provide this coverage in Alaska or by furnishing the Division of Workers' Compensation with proof of the employer's ability to pay the required benefits directly to the injured worker. The Division of Insurance regulates the insurance companies authorized to provide workers' compensation insurance in Alaska.

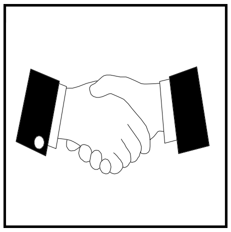
This booklet explains how insurance companies determine the premium charge for a workers' compensation insurance policy, and it provides information to assist in settling disputes between the employer and the insurance company over the amount of the premium. Questions regarding the costs of your insurance policy or actions by your insurance company should be addressed to the Division of Insurance.

This booklet does not provide information on determining whether or not an employer needs to provide workers' compensation coverage, nor does it provide help for filing claims or resolving disputed claims. Requests for exemptions for corporate officers and other questions regarding coverage requirements, benefits and claim settlement should be addressed to the Division of Workers' Compensation.

The Division of Workers' Compensation may be contacted at:

P.O. Box 25512
Juneau, AK 99802-5512
(907) 465-2790

Risk Sharing



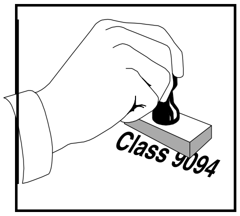
Insurance is the sharing or transferring of risk or uncertainty of financial loss. When an employer purchases workers' compensation insurance, the employer transfers the risk that one of his or her employees will become injured on the job to an insurance company who is willing to assume this unknown risk for a fee, called the premium. This benefits both the employer and the employee. The employer exchanges an unknown risk and possibility of large medical expenses for a known premium amount.

The employee knows that in case of on-the-job injury, the employee's expenses will be paid for by the insurance company.

Many employers may never have to use the workers' compensation insurance that state law requires them to purchase. This does not mean that only those employers whose employees are injured benefit from the mandatory insurance requirement. Employers who have good safety records also benefit since the possibility of large financial loss is eliminated. A single, large claim has the potential to financially ruin a small business. When an employee receives workers' compensation benefits, the employer is protected from lawsuits relating to injuries occurring in the workplace.

Classification

The Business Is Classified



The single most important factor which determines an employer's workers' compensation premium is the classification assigned to the employer. There are approximately 800 different classifications listed in the National Council on Compensation Insurance, Inc. (NCCI) Scopes of Basic Manual Classifications, a publication which provides detailed descriptions of each classification. A copy of this manual may be purchased from the National Council on Compensation Insurance, Inc., Products and Services, 750 Park of Commerce Drive, Boca Raton, Florida 33487, (800) 622-4123.

The workers' compensation classification system is designed to group employers with similar risk characteristics. Each classification should be as homogenous as possible, and at the same time be large enough to provide reliable indications of future losses. For this reason, the workers' compensation classification system is based on the business of the employer, not the individual employees within the business. An employer is assigned to the classification that best describes the normal business conducted by that employer.

There are several reasons for assigning classifications by business rather than by individual occupations within the business.

1. Although the individual employee receives the benefits of the workers' compensation insurance, it is the business which purchases the insurance and, therefore, the business is the insured.
2. The employer is responsible for all workers' compensation benefit payments, regardless of fault. By law, it is the employer who is liable for all costs, so employees are classified by the business of the employer rather than by their individual duties.
3. Classifying the business rather than the individual employees helps to promote safety. Safety programs sponsored by an industry or trade association may lower the number of accidents occurring among employers in that industry. When the safety records of employers in a classification improve, the rates for the classification tend to go down. If these same employers were to be spread out among several different classifications based on individual occupations within the business, the improved safety record of the industry may be diluted by the experience of employers in other industry groups who do not use the safety program.
4. Similar types of business have similar exposure to occupational injury. Since sharing of risk is the underlying premise for insurance coverage, grouping employers by type of business rather than individual employee occupations provides a means of predicting the cost to insure that type of business. If classification was done by individual duties, comparison of the risk by industry would not be possible.

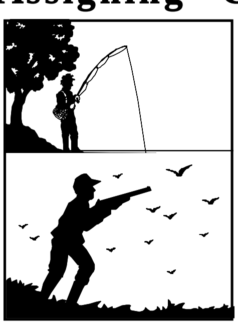
Standard Exceptions

There are a few occupations which are common to many types of businesses for which special classifications have been established. These special classifications are: Clerical Office Employees; Clerical Telecommuter Employees; Drafting Employees; Drivers, Chauffeurs and their Helpers; and Salespersons, Collectors or Messengers — Outside employees who fit into these categories are classified by occupation rather than by the type of business in which they are employed.

General Exclusions

There are a few occupations which are so unusual that they are not assigned the classification of the business in which they are employed. The occupations which are excluded from the classification assigned to the business are: Aircraft Operation; New Construction or Alterations By the Insured's Employees; Stevedoring; Sawmill Operations; and Employer-Operated Day Care Service.

Assigning Classifications



Each classification includes all of the occupations found in a business. The classification which best describes the business of the employer is the classification assigned to the business. The exceptions are those occupations which are listed above, either as standard exceptions or as general exclusions.

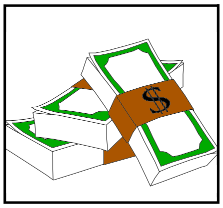
For example, a business which provides guides for hunting or fishing trips is assigned to Class 9094. Suppose this business employs three guides. One of the guides is also employed as a pilot to transport guests and the other two guides also have cooking and housekeeping duties. A fourth employee is a clerical worker. The guide who is the pilot is not rated in Class 9094, since his or her occupation is one of the general exclusions. The pilot is assigned to Class 7422, Aircraft or Helicopter Operation. The clerical worker is one of the standard exception classifications and is assigned to Class 8810, Clerical Office Employees. The remaining two guides, are assigned to the business class code 9094, Outdoor Guide Services.

Another example is a restaurant which has ten employees: two cooks, one busboy, three waiters or waitresses, a maitre d', a bookkeeper, a manager, and a musician to entertain its customers. The bookkeeper is assigned to Class 8810, Clerical Office Employees. All the remaining employees are assigned to Class 9079, Restaurant.

Determining the Premium

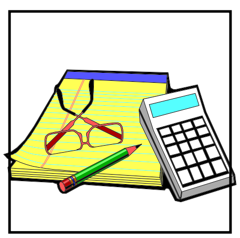
After the business has been assigned to the correct classification, the insurance company will calculate the estimated premium to be charged for the policy. The estimated premium is determined by multiplying the anticipated annual payroll of the business by the rate for the classification to which the business is assigned.

Premium Discount



Policies with larger premiums do not require the same percentage of the premium to be allocated to insurer expenses, such as policy acquisition and other administrative costs to place the policy on the insurer's books. To recognize the non-proportional nature of these expenses, insurers apply a discount to policies generating premium over a specified size. This is analogous to discounts given to purchasers of large quantities of manufactured goods where the price per item is less for multiple items than if only one item is purchased. Generally, a policy developing a total premium of over $10,000 is eligible for premium discounts, although the eligibility level may vary by insurer.

Minimum Premium

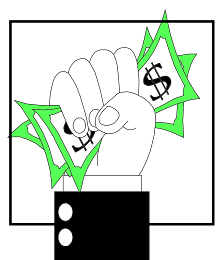


The premium an insurance company charges for a workers' compensation policy must be sufficient to cover the costs associated with issuing the policy as well as costs associated with the transfer of risk from the employer to the insurance company. The minimum amount of premium needed to cover these costs varies by classification. If the premium calculated by multiplying the total annual payroll (in hundreds) by the classification rate does not produce this minimum amount, the employer will be charged the classification minimum premium rather than the calculated premium. Such situations frequently arise when a business employs seasonal or part-time employees.

Suppose a jewelry store is operated as a sole proprietorship and the sole proprietor has not elected to be subject to the workers' compensation law. The sole proprietor employs a part-time sales clerk whose salary is $5,000. The 1998 premium for the jewelry store, class code 8013, would be $5,000 ÷ 100 x .78 = $39. The minimum premium for class 8013, Store: Jewelry, was $150. Since the calculated premium is less than the minimum premium, the policy minimum premium of $150 will be charged to the sole proprietor.

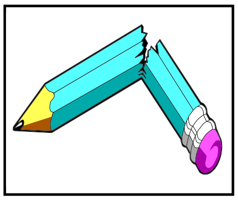
The rates used by most insurance companies in Alaska are developed by the National Council on Compensation Insurance, Inc. (NCCI). An explanation of the methodology used by NCCI to develop rates is found on page 16-18 of this booklet.

Payroll



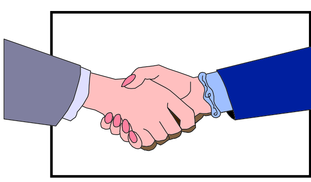
The premium that is charged to each employer must be based upon that employer's exposure to loss. For workers' compensation insurance this exposure is measured by payroll. Payroll does not provide a perfect measure between exposure to loss and the appropriate premium charge, but it has several advantages over other possible measures. First, payroll information is available for all employees, and employers can use the records they normally keep for their business operations to determine their payroll. No additional record keeping needs to be done. Second, since payroll adjusts to the costs of living and doing business, any inflationary changes to the costs of providing workers' compensation benefits are adjusted for in payroll levels, lessening the need for rate increases. Third, payroll is related to the benefit amount received by injured workers, since one of the benefits of workers' compensation insurance is a weekly income payment, the amount of which is related to the injured employee's pay rate.

Policy Audits



The premium calculated for a workers' compensation policy when the policy is purchased is an estimated premium, since it is based on estimated payroll amounts. The insurer requests actual payroll figures every year in order to determine if any adjustments to the estimated premium need to be made. The policy provides for auditing during the policy period and up to three years after the policy period ends.

Corrections to Classification Assignments



Occasionally a business is assigned to the wrong classification. This incorrect assignment may be discovered during the policy term or upon audit of the policy. If the correction results in a lower premium, the decrease will be applied to the policy retroactively. If the correction results in an increase in premium, the increase will be applied to the policy according to the following schedule as found in the NCCI Rating Manual.

When the insurer determines a corrected classification is needed:

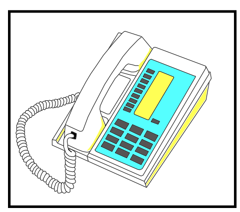
a. during the first 120 days of a policy term, the additional premium is applied retroactively to the entire policy period,

b. after the first 120 days but before the last 90 days of a policy term, the additional premium is applied pro rata from the date the insurer discovers the cause for the change,

c. during the last 90 days of the policy term, the correct classification and additional premium will be applied only to the renewal policy.

If a change in classification is due to changes in the insured's operations, the new classification will be applied pro rata from the date of change in the insured's operations. If a change in classification is needed because of an omission or misrepresentation by the insured or agent, the new classification will be applied retroactively.

How to Solve Classification Disputes



An employer has the right to appeal any classification assignment and premium amount sent to him or her by the insurer. The first step would be to try to resolve the disputed classification with the insurance company. One of the functions of NCCI, as the rating organization for workers' compensation insurance, is to attempt to resolve classification disputes if possible. An NCCI Customer Service Consultant may be contacted at 1-800-622-4206. Written requests for NCCI arbitration may be addressed to:

Workers' Compensation Classification
and Appeals Consultant
National Council on Compensation
Insurance, Inc.
Oswego Towne Square
Nine Monroe Parkway, Suite 140
Lake Oswego, OR 97035

If NCCI is unable to resolve the dispute, the insured may appeal to the Alaska Review and Advisory Committee (R&A Committee). Currently, the R&A Committee has ten members. Two are producers (insurance agents or brokers), three are private employers, and five are representatives of insurance companies writing workers' compensation insurance in Alaska. NCCI acts as the secretary for the Committee and has no vote. An appeal to the R&A Committee may be made by requesting a hearing. These hearings are held in Anchorage every three to four months. Written requests for a hearing should include the nature of the dispute and should be addressed to:

Alaska Review and Advisory Committee
National Council on
Compensation Insurance, Inc.
Oswego Towne Square
Nine Monroe Parkway, Suite 140
Lake Oswego, OR 97035

A copy of the request should be sent to:

State of Alaska
Division of Insurance
P.O. Box 110805
Juneau, AK 99811-0805

When appearing before the R&A Committee, your agent or broker may accompany you. You may also have an attorney if you wish. Copies of any documents that support your grievance should be made available to each committee member. After the hearing, the Committee will notify you of its decision within 30 days.

If the R&A Committee decision is not satisfactory, the employer may appeal to the Division of Insurance. The reason for the appeal and a request for a hearing must be sent to the division within 30 days after notification of the R&A Committee decision. A hearing officer will be assigned to hear the grievance. After the hearing, an order will be prepared for the director to adopt or refuse. If this still does not satisfactorily resolve the dispute, the appeal may be pursued through the courts.

The employer does not need to pay the disputed premium until the dispute is resolved. However, if it is determined that the assigned classification is correct, the employer must pay the disputed premium in full.

Sole Proprietors and Corporate Officers

Under Alaskan laws, a person who operates a business as a sole proprietor or a member of a partnership is not required to obtain workers' compensation coverage for himself or herself. However, a sole proprietor or member of a partnership may elect to be covered by the workers' compensation law. If this election is made, the sole proprietor or member of a partnership has the same status as any of his or her employees under the business' workers' compensation insurance policy.

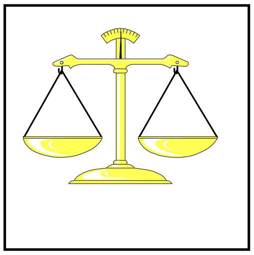
Executive officers of a corporation are considered to be employees of the corporation for purposes of the workers' compensation laws. However, an executive officer may elect to be excluded from coverage under the corporation's workers' compensation policy, provided the officer has received an Executive Officer Waiver from the Alaska Department of Labor, Division of Workers' Compensation. Payroll for all executive officers will be included in determining the policy premium if the corporation has not been granted a waiver.

Members of limited liability companies are treated in the same manner as members of a partnership for the purposes of workers' compensation coverage.

Any questions or requests for additional information should be addressed to the Division of Workers' Compensation. Contact information can be found on Page 1.

Experience Rating

What is Experience Rating?



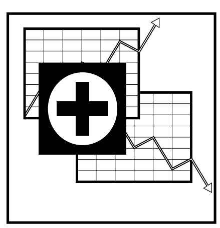
After the classification is assigned and the premium is calculated using the rate per $100 of payroll times the payroll divided by 100, many insureds are eligible for experience rating. Experience rating is a procedure which uses each individual employer's own loss experience to recognize differences between the employer and the average risk in the class. If an employer has better experience than the average, the employer receives a premium credit. If an employer has worse experience than the average, a premium debit is applied. The benefits of experience rating are 1) that it provides an incentive for loss prevention and implementation of safety programs by the employer and 2) that the premium for each insured reflects the individual insured's experience and should be a better indication of the costs of future losses than the average rate for the classification.

Since experience rating is based on past losses, three years of loss history are generally used to calculate the experience modification. An average annual premium of $2,500 over the past three years is needed to be eligible for experience rating. If three years of experience are not available, an insured may still qualify for experience rating depending upon the size of the insured.

The appropriate debit or credit modification is calculated during the term of the current policy to apply to the renewal policy; therefore, the experience period is the three years ending one year prior to the effective date of the modification. For example, if an experience modification is to become effective on January 1, 1999, the experience period consists of policies effective on January 1, 1995, January 1, 1996, and January 1, 1997. Data or losses under the policy effective on January 1, 1998, are not yet available when the 1999 modification is being calculated.

The National Council on Compensation Insurance, Inc. calculates the experience modification for each employer. The modification applies for one year and will be used by any insurer which insures the business. An employer may receive a copy of his or her experience rating worksheet by requesting a copy from NCCI. Your producer and insurance company have access to this worksheet. Other entities will be allowed access to the experience rating worksheet only at the employer's option. This option may be exercised by providing NCCI a letter of authority written on the employer's letterhead and signed by an owner or officer of the company.

How Experience Rating Works



Two factors are considered in determining whether an experience modification is needed and what the amount of the modification should be. The first factor is called the accident frequency. The frequency is a measure of how many accidents an employer has had during the experience period. The second factor is called the accident severity. The severity measures the cost of any accidents that have occurred.

The more important of these two factors is the accident frequency. For example, suppose there are two employers of comparable size in the same industry and one employer has one injured employee with a loss of $75,000 and the other employer has 10 injured employees, each claim equal to $5,000. Which employer is more likely to have claims in the future? The employer with several claims. While there is no guarantee that the second employer's claims will always be small, there is a higher probability that another accident will be experienced by the second employer than by the first employer.

Even though the accident frequency is a better indication of future losses, experience rating does not ignore the cost of those losses. The costs of each claim are divided into two parts. The first $5,000 of each claim are called primary losses; the remaining cost of the claim is called the excess loss. All of the primary loss is used to calculate the experience modification, but only a percentage of the excess loss is used. An employer may have no losses for many years and then experience a single large loss. By using only a percentage of the excess loss, the increase in the experience modification is tempered. The percentage of excess loss is determined by the size of the employer's payroll.

Example

The employer whose loss for one injured employee is $75,000 will have only $5,000 in primary losses. The remaining $70,000 are excess. The employer with 10 injured employers, each claim equal to $5,000, will have $50,000 in primary losses and no excess losses. The second employer will receive a larger debit than the first, even though the first employer's total losses are higher than the second employer's.

Safety Program Discounts

Alaska law requires that all insurers providing workers' compensation insurance establish and make available to all its insureds a workplace safety rate reduction program. Ask your insurer what you need to do to be eligible for these premium credits.

Assigned Risk Pool

Employers who are required by law to have workers' compensation insurance may find themselves unable to purchase coverage from an insurance company. An insurance company has the right to determine that a particular occupation is too risky and decide not to insure employers engaged in that occupation. An insurer may also specialize by writing employers that develop a large amount of premium. Different insurers accept different types of risks. When one insurer is unwilling to insure a particular business, another insurer may find the business to be acceptable.

If an employer is unable to find an insurance company willing to provide him or her with workers' compensation coverage, the coverage may be obtained through the Alaska Workers' Compensation Assigned Risk Pool. Your producer (agent or broker) can help you apply for coverage through the Pool. All insurance written through the Pool uses the classifications, rates, and rating plans promulgated by the NCCI. Alaska Statutes allow a surcharge to be applied to the premium when insurance coverage is purchased through the Pool. The surcharge amount is 25% of the premium developed at NCCI rates; but the first $3,000 of premium is exempt from the surcharge. A policy whose premium is $2,500 in the voluntary market also has a premium of $2,500 in the Pool. A policy whose premium would be $7,000 in the voluntary market may be purchased for $8,000 in the Pool. The surcharge of $1,000 is calculated as follows:

Total premium in voluntary market:
$7,000

Premium exempt from surcharge:
$3,000

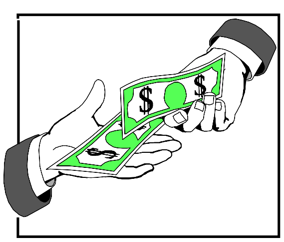
Premium subject to surcharge:
$7,000 - $3,000 = $4,000

Amount of surcharge:
$4,000 x .25 = $1,000

Total premium in the pool:
$7,000 + $1,000 = $8,000

Premium discounts are not available on policies written in the Assigned Risk Pool.

Installment Payments



Alaska Statutes require insurers to offer installment payment plans if the annual policy premium exceeds $2,000.

These installment payment plans are implemented at the request of the insured. Ask your producer or insurer about the options available from your insurance company.

Rates or Loss Costs - Who Makes Them

Definitions

A rate is the amount per $100 of payroll that is needed to cover losses and expenses. The premium is the charge for the insurance, which is calculated by multiplying the rate times the employer's payroll divided by 100. For example, the 1998 rate for Clerical Office Employees (class code 8810) is $.54 per hundred dollars of payroll. A business consisting of one clerical worker with a payroll of $30,000 will pay a premium of $162.00 for one year of workers' compensation coverage for that clerical worker. The premium is calculated as follows. The payroll is divided by 100. The result is 30000 ÷ 100 = 300. Then the rate is multiplied by 300 to calculate the premium, or 300 x .54 = $162.00.

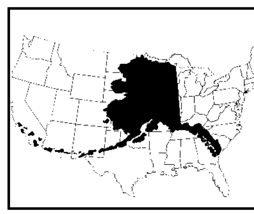
A rating organization is an entity licensed by the Division of Insurance for the purpose of aggregating data from multiple insurance companies. This aggregate data is then used as the basis for developing rates that will be used by insurers who are members of the rating organization.

Division of Insurance

The Division of Insurance licenses organizations called rating organizations, that provide data collection and ratemaking services to insurers writing insurance in Alaska. The Division of Insurance has regulatory oversight of these services. The purpose of this oversight is to allow premiums that cover the cost of providing insurance coverage while avoiding unreasonable profits by insurers. This oversight is carried out under provisions in Alaska's laws that state rates shall not be excessive, inadequate, or unfairly discriminatory.

Rates developed by a rating organization must be submitted to the Division of Insurance and are reviewed to determine if they comply with the law. Historical data, along with assumptions about future loss conditions, are provided by the rating organization, and insurance companies provide expense data to support the proposed rates. The Division of Insurance does not set the rates used by insurance companies.

National Council on Compensation Insurance, Inc.



Most insurance companies in Alaska (as well as in 37 other states) provide workers' compensation insurance at the rates which are based upon loss costs determined by the National Council on Compensation Insurance, Inc. (NCCI). NCCI is a rating organization. As a rating organization, NCCI collects statistics from all insurance companies writing workers' compensation insurance, combines the data and uses the aggregate data to develop appropriate loss costs. Loss costs developed using large quantities of data will more accurately reflect the costs of providing the insurance coverage than loss costs developed by an individual company. Aggregate data also helps prevent large swings in rates from year to year.

1998 and 1999 Changes

In 1998 and 1999 several changes took place in the way the premium for workers' compensation policies is determined.

The major change is that the workers' compensation rating organization, the National Council on Compensation Insurance, Inc. (NCCI), will develop loss costs rather than rates.

Every rate consists of two parts; one part is the amount needed to pay for losses such as medical expenses and lost wages, the other part is the amount needed to pay the operating costs of the insurance company such as salaries, rent, heat, lights, and profit. When a rating organization develops **rates**, the operating cost portion of the rate is an average expense amount calculated using data from all insurance companies. This average amount is added to the amount needed to cover losses. For a **loss cost** rating system, the rating organization calculates only the loss portion of the rate. Each insurance company calculates its own expense needs and adds its own expense amount to the rating organization loss amount. Under either a rate system or loss cost system, the rate consists of a portion to cover losses and a portion to cover expenses. The difference is only in who determines the expense amount, the rating organization or the insurer. If the rating organization determines the expenses, the expense portion is the same for all insurers; if the insurer determines the expenses, the expense portion will vary by insurer.

When a rating organization develops only loss costs, each insurer must develop its own expenses and submit a filing to the Division of Insurance to have the expense loading approved before the insurer can use it. For 1998, the Division of Insurance requested the rating organization to develop and file both rates and loss costs. This would give insurers time to adjust to the new filing requirements. Insurers were able to develop and submit their expense filings, called loss cost adjustment filings, any time during 1998. For 1999, only loss costs would be available for use by insurers writing voluntary business. The Assigned Risk Pool will continue to use rates developed by NCCI.

The following example using data from the 1998 NCCI rate and loss cost filings for Class Code 2710, Sawmill, should help explain the differences under the two rating systems.

George, of George's Sawmill, decides to contact three insurance companies before purchasing his workers' compensation policy. One of the insurers elected to use the NCCI rates and the other two elected to use the loss cost rating system.

Rates
Using expense data collected from all insurance companies, NCCI determined that on average 26.5% of the rate was used for insurer expenses. The average benefit cost, or loss cost, per $100 of payroll was determined to be $8.75. The NCCI rate was calculated as follows:

1998 NCCI rate	=	benefit amount	+	expense amount
$11.90	=	$8.75	+	$3.15

In other words, if George were to purchase workers' compensation insurance from ABC Insurance Company which elected to use the 1998 NCCI rates, George's Sawmill would pay a rate of $11.90 per hundred dollars of payroll for its workers' compensation policy.

Loss Costs
Any insurer who converted to the loss cost system in 1998 would use the benefit amount of $8.75 determined by NCCI, but not the expense amount.

KLM Insurance Company, who elected to use the 1998 loss cost rating system, determined that its expense needs were only 24% of the rate, or $2.76.

1998 KLM rate	=	benefit amount	+	expense amount
$11.51	=	$8.75	+	$2.76

The third insurer, XYZ Insurance Company, who also elected to use the 1998 loss cost rating system, determined that its expense needs were 30% of the rate, or $3.75.

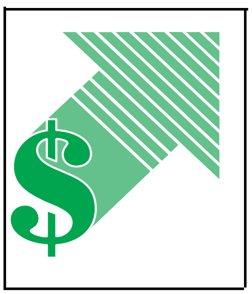
1998 XYZ rate	=	benefit amount	+	expense amount
$12.50	=	$8.75	+	$3.75

The following table summarizes the rates used by the three insurers.

Insurer	Benefit Amount	Expense Amount	Total
ABC	8.75	3.15	11.90
KLM	8.75	2.76	11.51
XYZ	8.75	3.75	12.50

In selecting which insurer George wants to purchase his workers' compensation policy from, price alone should not be the basis for making his decision. Other considerations include the quality of service provided by the producer and insurer, the speed at which claims are settled, and the reputation and financial condition of the insurer.

Schedule Rating



There are some workplace characteristics of individual businesses that are not reflected in the class rates or the experience rating plan because they cannot be objectively quantified. In order to recognize these characteristics, insurers use judgmental credits and debits to adjust the premium charged for a policy. Some examples of the types of characteristics that are considered are:

- Adequacy of first aid equipment and supplies
- First aid trained personnel
- Cleanliness of the workplace
- Written job safety procedures
- Supervisor training of new employees
- Activities that are unusual for the type of business or industry

Each insurer develops its own schedule rating plan which consists of the characteristics to be considered and the amount of the credit or debit for each characteristic. Each insurer also establishes its own criteria to determine which insureds are eligible for schedule rating. One insurer may decide to apply schedule rating only to insureds that are eligible for experience rating, while another insurer may decide to apply its schedule rating plan to all insureds. Every schedule rating plan must be filed with and approved by the Division of Insurance before it can be used.

What is the effect of a loss cost system on schedule rating?

The characteristics used to determine a schedule credit or debit will not change based upon whether an insurer uses the rate system or the loss cost system. For example, if an employer receives a credit for having medical facilities on site under the rate system, a credit would still be given when the insurer converts to the loss cost system. However, because the expenses included in rates may vary from one insurer to another, the size of the debit or credit cannot be used as the sole means of determining which insurer will quote the lower premium policy.

Suppose George's Sawmill is eligible for schedule rating from all three insurance companies that George contacted. ABC Insurance Company offers a 5% medical facilities credit, KLM Insurance Company offers a 3% credit and XYZ Insurance Company offers a 10% credit. George should not assume that XYZ Insurance Company has the lowest premium simply because they will give him the largest schedule credit.

Insurer	**Rate**	**Credit**	**Discounted Rate**
ABC	$11.90	5%	$11.31
KLM	$11.51	3%	$11.16
XYZ	$12.50	10%	$11.25

In spite of giving the smallest percentage schedule credit, KLM Insurance Company has the smallest rate and hence will have the lowest premium policy.

What is the effect of a loss cost system on experience modifications?

The calculation of the experience modification will not be affected by the implementation of a loss cost system. An experience modification greater than one indicates an employer has worse loss experience than the average employer in the class, while an experience modification less than one indicates an employer has better than average loss experience. This will be true whether the insurer uses a rate system or a loss cost system as its rating structure.

Ratemaking

Selecting an accurate loss cost is not an easy task. Much of the difficulty lies in the fact that a price for workers' compensation coverage must be determined before the costs of the coverage are known. The question that needs to be answered is "Will the premium collected cover the losses and expenses that are expected to occur from all policies issued during the year, no matter how far into the future benefits will be paid to employees injured during the year?"

NCCI uses the following procedure to answer this question.

Adequacy of Premium Level

First, NCCI determines the required overall change in the statewide premium level. To do this, NCCI collects data showing the total premium for all employers in Alaska for a given year, and the amount paid out as benefits during the year—both indemnity payments (weekly compensation for lost wages) and medical payments. Since NCCI is estimating future costs, the historical experience is adjusted for inflation. If the amount needed for benefits is greater than the total premium that would be collected if loss costs remain unchanged, the overall premium level needs to be increased. If the amount needed for benefits is less than the total premium that would be collected if loss costs remain unchanged, then the premium level needs to be decreased.

Example

Gathering Historical Data

The following example is taken from the 1999 NCCI loss cost filing. Based on data collected from policies issued in 1996 and using the loss costs in effect in 1998, NCCI estimated that $121,000,000 will be collected in premiums from all workers' compensation policies written in Alaska in 1999. In 1996, indemnity benefits were $51,000,000 and medical benefits were $61,000,000.

Adjusting For Inflation

Indemnity benefits were estimated to decrease 3.5% per year. Since indemnity benefits are tied to salary level, the changing Alaskan employment market is likely responsible for this decreasing trend. Service industry and tourism related jobs are becoming a larger portion of the workforce while higher paying jobs in timber and oil industries are declining.

Medical benefits were estimated to decrease 0.1% per year considering both inflation and other factors affecting the costs of medical treatment. These other factors include 1) any changes in the number of claims being filed by injured employees, and 2) any changes in the length of time injured employees receive benefits.

Since 1996 experience is used to estimate 1999 costs, the changes due to inflation must be calculated for three years. The total decrease over three years for indemnity benefits is $(1 - .035)^3 = .899$ or -10.1% and for medical benefits the decrease is $(1 - .001)^3 = .997$ or -0.3%.

Therefore, indemnity benefits for 1999 are expected to be

.899 x $51,000,000 = $45,850,000

and 1999 medical benefits are expected to be

.997 x $61,000,000 = $60,800,000.

The total estimated benefits to be paid in 1999 are

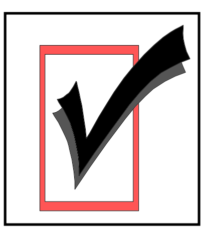
$45,850,000 + $60,850,000 = $106,650,000.

Final Loss Cost Level

NCCI calculates the overall premium adequacy based upon three years of historical experience. Each year's indication is computed separately. The final indication is an average of the indicated changes for three years. The 1999 loss cost filing used indications from 1994, 1995, and 1996.

Data from 1997 and 1998 is not available to NCCI when they begin work on the 1999 loss costs. Any policy written toward the end of 1997 will not expire until the end of 1998. The most recent data available to NCCI is always from policies written three years prior to the year the new loss costs become effective.

Loss Cost Level Change



After the required overall loss cost level is determined, any loss cost changes necessary to produce the appropriate amount of premium are calculated. If it has been determined that the loss cost level needs to be adjusted, the loss cost for each classification is individually changed. The loss cost for every classification is not increased or decreased by the same amount. Two steps are used to calculate the loss cost level change by classification.

Industry Group Indications

Each classification is grouped into one of six Industry Groups. These groups are: Manufacturing, Contracting, Office and Clerical, Goods and Services, Miscellaneous, and Oil and Gas. The loss cost level change for the Industry Group as a whole is calculated. For example, the data used to calculate the 1999 loss costs showed that employers in the Office and Clerical Industry Group, on the average, had worse experience than all employers from all Industry Groups combined. Therefore, the Office and Clerical Industry Group received an 8% decrease in premium level, which is a smaller decrease than the overall statewide decrease of 8.5%.

Classification Indications

The second step in calculating the loss cost change for each classification distributes the Industry Group change to each class in that Industry Group. To do this, payroll information from all Alaskan employers along with the benefits paid out to injured Alaskan employees for the last five years are grouped by classification. An average benefit cost per $100 of payroll is calculated. For example, the Manufacturing Group, Class 2710, consists of the experience of Sawmills. The five year total payroll is $34,400,000 and total benefits paid out over five years are $2,700,000. The average benefit cost per $100 of payroll is found by dividing the benefits paid by the total payroll and multiplying this result by 100, or

$$\frac{\$\ 2,700,000}{\$\ 34,400,000} \times 100 = \$7.84$$

This says that if every employer in Class 2710 pays $7.84 for every $100 of payroll, enough money should be collected from employers in Class 2710 to pay the medical and indemnity benefits of any injured employee who works in a Sawmill.

Adequacy of Benefit Cost Per $100

How good is this average benefit cost per $100 of payroll in evaluating the correct rate level? The answer to this varies for each classification depending upon the volume of experience in that class. Classifications which have many employers and large amounts of payroll will produce rates which can be relied upon, whereas classifications with only a few employers and small amounts of payroll may produce loss costs which are not valid indications of future loss.

When there is not enough Alaskan experience to produce valid loss costs, the Alaska indication is averaged with a national indication. This national loss cost indication is calculated in the same way as the Alaskan loss costs, the only difference being total payroll and benefits paid are aggregate amounts from employers countrywide, not just Alaskan employers.

Within each Industry Group, some classifications may have loss cost increases and some may have loss cost decreases. However, the rate level for the Industry Group as a whole must equal the average loss cost level change found in the first step of the loss cost level change procedure.

Final Rates

Assigned Risk Pool

For policies written in the Assigned Risk Pool, NCCI calculates rates (rather than loss costs). To produce the final rate for each classification, the indicated average benefit cost determined above is combined with an amount to cover the business operating costs of the insurance company. Over the last few years, approximately 26% of the total premium collected is designated as the provision for overhead expenses, leaving 74% of the premium to be used for benefit payments.

For a Sawmill operation assigned to Class 2710, the final 1999 assigned risk rate consists of $7.84 to pay the medical and indemnity benefits plus the expense amount of $3.12, for a total rate of $10.96.

Voluntary Market

For policies written in the voluntary market, each insurer adds its own company expense provision to the NCCI loss costs. Individual insurer expense percentages range from 5% to 35% of the rate, with an average of 20%. The final rate varies by insurer. For a sawmill operation assigned to Class 2710, the 1999 rate would range from $8.35 to $12.00.

While the range of expense percentages appears to be large, many of the insurers with lower expenses are specialized companies or companies with a particular market niche. Different insurers accept different types of business, so the actual range of rates available to an employer may not be as broad as the different expense amounts indicate.

Other Publications

The Alaska Division of Insurance has several other publications designed to help educate the insurance-buying public. All publications listed below are available by contacting the Division in either the Juneau or Anchorage office.

Alaska Division of Insurance
P.O. Box 110805,
Juneau, Alaska 99811-0805
(907) 465-2515

and

3601 C Street, Suite 1324,
Anchorage, Alaska 99503-5948
(907) 269-7900

1. The **Insurance Consumer Guide** is designed to provide the consumer with a general overview helpful for anyone wishing to purchase auto insurance, homeowners insurance, life insurance, or health insurance. It is also designed to help consumers better understand their insurance rights. It explains some of the insurance basics that will be useful in determining what types of coverage may be needed periodically. This brochure is distributed to consumers as a newspaper supplement with the most recent version printed in June 1994.

2. The **Homeowners Insurance Rating Examples** booklet explains homeowners coverage and compares the rates from various companies.

3. The **Private Passenger Auto Insurance Rating Examples** booklet explains auto insurance coverage and compares the rates from various companies.

4. The **Annual Insurance Report** is published every year and costs $25 per copy. This report is a summary of all the insurance business written in the state, premium taxes collected, license statistics, consumer complaints, and disciplinary actions.

5. A **Guide to Health Insurance for People with Medicare** provides information about Medicare, the different types of private health insurance that can be used to fill gaps in Medicare coverage, and tips on shopping for private health insurance to supplement Medicare.

6. The **Consumer's Guide to Long-Term Care Insurance** discusses the cost of long-term care, kinds and types of coverage available, what kinds of limits there are, and what types of questions you should ask before buying this coverage.

7. The **Medicare Supplement Insurance Rating Examples** booklet explains the different types of medicare supplement insurance and compares the rates from various companies.